

**LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 6757

BILL NUMBER: SB 187

NOTE PREPARED: Dec 15, 2004

BILL AMENDED:

SUBJECT: Elimination of Inheritance Tax.

FIRST AUTHOR: Sen. Zakas

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill exempts Class A transferees from the Inheritance Tax beginning January 1, 2006. The bill phases out the Inheritance Tax for Class B and Class C transferees by increasing exemption amounts in 2006 and 2007. It provides that the Inheritance Tax does not apply to Class B and Class C transferees after December 31, 2007. The bill also provides that the Estate Tax does not apply to the estate of an individual who dies after December 31, 2004. It also provides that the Generation Skipping Transfer tax does not apply to a generation skipping transfer that occurs after December 31, 2004.

Effective Date: January 1, 2005 (retroactive); July 1, 2005.

Summary of Net State Impact: Under the bill the state will experience a progressively larger reduction in Inheritance Tax revenue from FY 2007 to FY 2010 when the state will no longer receive revenue from the tax. The bill is also expected to increase state General Fund expenditures on county Inheritance Tax replacement. The impact of the bill on state revenues and expenditures is summarized in the table below.

Fiscal Year	Inheritance Tax Revenues	Add'l. State Expenditures for County Replacement	Net Increase (Decrease)
2007	(\$39.2 M)	(\$0.8 M)	(\$40.0 M)
2008	(79.8 M)	(3.9 M)	(83.7 M)
2009	(100.6 M)	(5.7 M)	(106.3 M)
2010 and after	(120.0 M)	(7.3 M)	(127.3 M)

Explanation of State Expenditures: *Department of State Revenue:* If the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff of the Inheritance Tax Section of the Department of State Revenue. The November 4, 2004, state staffing table indicates that the Inheritance Tax Division has 12 full-time employees with an annual salary of about \$335,000. The Division also has 2 vacant full-time positions. Since staff will be needed to process returns during the phaseout of the Inheritance Tax, a specific savings due to staff reductions could not be estimated.

County Inheritance Tax Replacement: The bill could increase expenditures from the state General Fund for county Inheritance Tax replacement beginning in FY 2007 as specified in the table below. These calculations represent upper bounds, and necessary replacement amounts may vary depending on whether and by how much each county's base Inheritance Tax revenue differs from the amount guaranteed under current statute. As a result, the impact is estimated to total approximately \$7.3 M annually beginning in FY 2010 once revenue from the Inheritance Tax comes to an end.

Fiscal Year	Add'l. State Expenditures for County Replacement
2007	(\$0.8 M)
2008	(3.9 M)
2009	(5.7 M)
2010 and after	(7.3 M)

Explanation of State Revenues: *Summary:* The bill would lead to progressively larger reductions in Inheritance Tax revenues from FY 2007 through FY 2010 when the tax is eliminated and no longer generates revenue. The revenue loss from the phaseout is shown in the table below.

Fiscal Year	Inheritance Tax Revenues
2007	(\$39.2 M)
2008	(79.8 M)
2009	(100.6 M)
2010 and after	(120.0 M)

The bill also repeals the Indiana Estate Tax with respect to the estate of a decedent who dies after December 31, 2004; and the Generation Skipping Transfer Tax on property transfers occurring after December 31, 2004. It is estimated that these two changes will not have a significant impact on state revenues.

Background: The bill eliminates the Inheritance Tax for Class A transferees (lineal descendants) beginning with transfers of decedents who die after December 31, 2005. The bill also phases out the Inheritance Tax for other transferees over a three-year period by providing an increasing exemption against taxable estate value. The exemption increases would apply to transfers made by persons who die within the dates specified in the following table. Since the Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5% early payment discount), the initial impact would not be experienced until FY 2007.

Transfers made from persons dying in ...	Exemption for Class A Transferees	Exemption for Class B Transferees	Exemption for Class C Transferees
2005 and before (current statute)	\$100,000	\$500	\$100
2006	100%	100,000	20,000
2007	100%	120,000	24,000
2008 and after	100%	100%	100%

The estimated impact of the phaseout of the Inheritance Tax is based on the Revenue Technical Committee's FY 2007 forecast (published December 14, 2004). This forecast estimates FY 2007 Inheritance Tax at \$120.0 M. The estimated revenue loss from the exemption assumes that Inheritance Tax revenues would remain relatively constant after FY 2007 absent the phaseout.

Estate Tax: The repeal of the Estate Tax will not have a fiscal impact since the tax will be eliminated beginning in 2005 due to federal law changes. Under current statute, Indiana Estate Tax is owed on the assets of an estate if: (1) federal Estate Tax is owed on the estate; and (2) the Indiana portion of the *state death tax credit* for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. So, the Indiana Estate Tax is equal to the difference between the state death tax credit and the Indiana Inheritance Tax. However, under the federal *Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)*, the state death tax credit will be eliminated for estates of decedents who die after December 31, 2004. At this point the Indiana Estate Tax will no longer be collected because the state death tax credit will no longer apply. The federal Estate Tax will be eliminated in 2010. It is important to note that the provisions of the federal legislation

repealing the federal Estate Tax are scheduled to sunset at the end of 2010. As a result, the 2001 federal Estate Tax provisions will automatically be reinstated on January 1, 2011. The Congress has failed to enact legislation to extend the repeal provisions or make them permanent.

Generation Skipping Transfer Tax: Like the Indiana Estate Tax, the Indiana Generation Skipping Transfer Tax is also linked to the federal version of the tax. The federal Generation Skipping Transfer Tax is also repealed in 2010 under *EGTRRA*, with the tax being reinstated in 2011 unless the repeal is made permanent. From FY 1993 to FY 2003, this tax reportedly generated no revenue. The tax did generate \$31,254 in FY 2004.

Explanation of Local Expenditures:

Explanation of Local Revenues: The phaseout of the Inheritance Tax could result in an annual revenue loss to counties beginning in FY 2007.

Fiscal Year	Local Share of Inheritance Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2007	(\$3.4 M)	\$0.8 M	(\$2.6 M)
2008	(6.9 M)	3.9 M	(3.0 M)
2009	(8.7 M)	5.7 M	(3.0 M)
2010 and after	(10.4 M)	7.4 M	(3.0 M)

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. Counties are guaranteed a statutorily determined amount as determined by the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years.

Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure. From FY 2000 to FY 2003, counties exceeded their guarantee amounts by an average of \$4.7 M annually with shortages subject to replacement averaging about \$200,000 per year. The total annual guarantee to counties is \$7.4 M. As a result, some reductions in county revenue exceeding the guarantee amount will not be replaced by the state.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast (December 14, 2004).

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